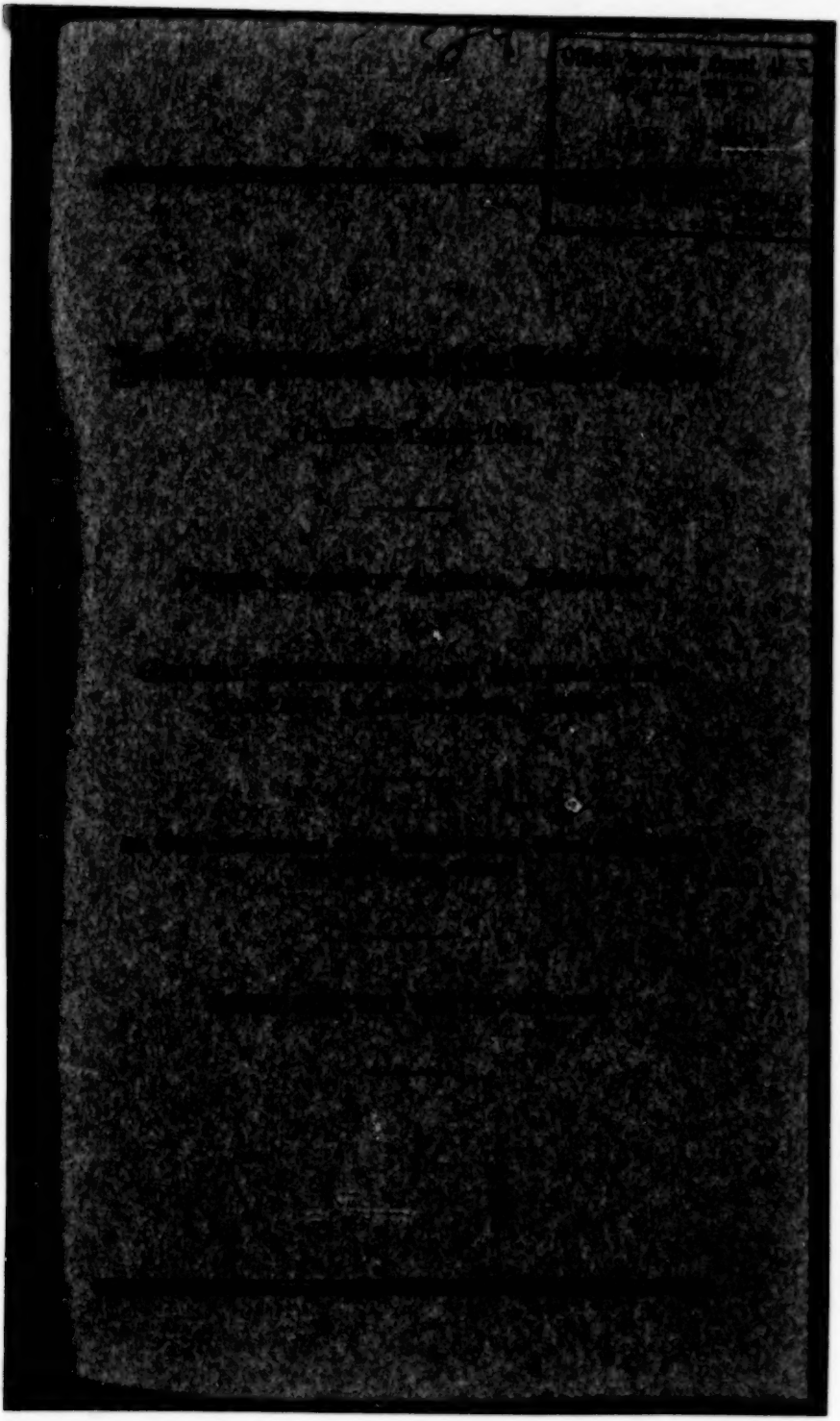
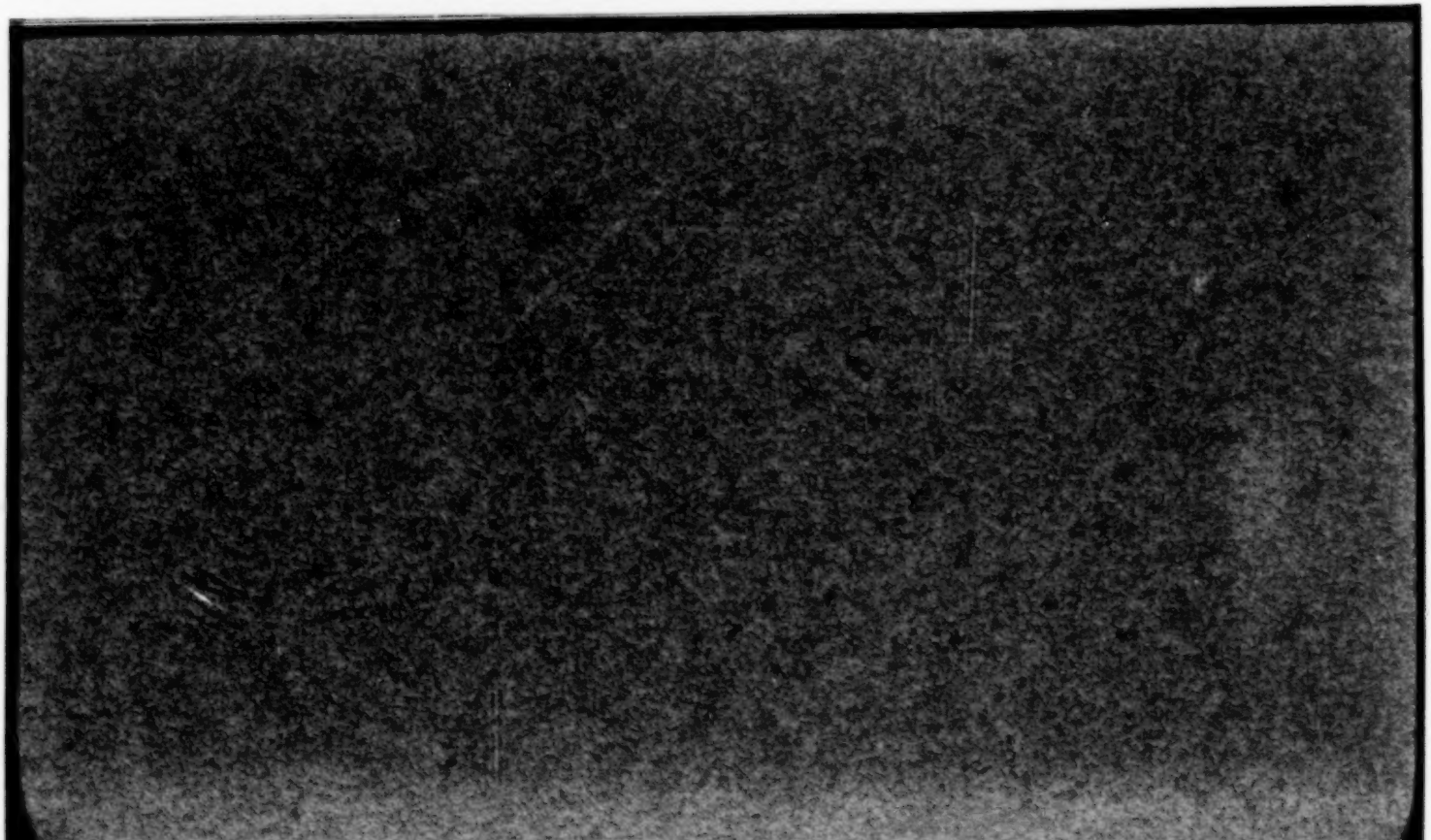




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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 300

UNITED STATES OF AMERICA, *Petitioner*

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, a Corporation, *Debtor*

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

---

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum opinions of the referee in bankruptcy (R. 8-14) and of the District Court (R. 19-22) are unreported. The opinion of the Court of Appeals (R. 25-29) is reported in 188 F. 2d 80.

JURISDICTION

The judgment of the Court of Appeals was entered on April 11, 1951 (R. 29). By order of Chief Justice Vinson, dated July 3, 1951 (R. 31), the time within which a petition for a writ of certiorari might be filed was extended to and including September 8, 1951. The petition for a writ of certiorari was filed September 4, 1951, and was granted on November 5, 1951 (R. 32). The jurisdiction of this Court rests on the provisions of 28 U. S. C. 1254.

QUESTION PRESENTED

Whether, in an arrangement proceeding under Chapter XI of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for arrangement.

STATUTES INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 21-30.

STATEMENT

There is no dispute as to the facts (R. 17-18) which may be summarized as follows:

The debtor's petition for an arrangement was filed November 17, 1948. The debtor is a corporation which for many years has been engaged in the manufacture of shapers (machine tools) and more recently commercial air-conditioning equip-

ment. The plan proposed in the original petition was in the nature of an extension, but this was abandoned. It was apparent that the best interests of the creditors would be served if the air-conditioning division of the business could be sold as a going concern rather than have an immediate liquidation of the company. In order to maintain the business, together with its distributorship system, for such sales purposes, operations were continued under court order. A purchaser for the air-conditioning division was obtained after several months of negotiations and a plan formulated which was subsequently approved by creditors and confirmed by the court. Under this plan, the debtor's air-conditioning division was sold to a manufacturer of heating equipment, the sale including all of the debtor's real estate and buildings. From the proceeds of sale of the real estate, there was deposited in court $204,000 for the payment in full of claims of $100 or less, and the payment of priority claims. The deposit was more than the amount required, and the balance is to be paid to a liquidating corporation for the benefit of general creditors (R. 26-27).

The remaining proceeds of the sale, together with the debtor's machinery and equipment for manufacture of shapers and certain other assets, were transferred to the liquidating corporation, the stock of which is held by a creditors' committee. Its assets are, upon liquidation, to be dis-

tributed upon a proportionate basis to the general unsecured creditors. This method was adopted since part of the purchase price was in notes payable over four years and because liquidation of certain inventories would require a period of time (R. 26-27).

Certain shaper inventory, not to exceed in value $135,000, and shaper patents, drawings, jigs, etc., were retained by the debtor. The debtor has no remaining facilities left for manufacture of shapers, but contracts with other tool manufacturing companies to manufacture them under its patents and in the process uses up the shaper inventory retained (R. 26).

No objections to this plan were filed at any time prior to its confirmation. Having been accepted by the required creditors affected, it was confirmed on September 13, 1949 (R. 27).

The United States, on February 23, 1949, filed an amended claim for social security and withholding taxes (R. 8). By agreement of the parties, to eliminate certain objections made by the debtor, a second amended claim for these taxes was filed on April 7, 1950 (R. 8). The taxes, with accrued interest to November 17, 1948, the filing date of the arrangement petition, aggregated $25,156.27 (R. 4). In addition, the claim asserted interest from the date of the petition to the date of payment (R. 4). After hearing, the referee allowed the claim for taxes and accrued interest through November

16, 1948, but sustained the debtor's objections to interest for the period beginning November 17, 1948 (R. 7). The District Court confirmed the order of the referee (R. 22), and, on appeal by the United States, the court below affirmed (R. 25-29).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In holding that interest on unpaid tax claims of the United States should be allowed only to the date of filing of the petition for an arrangement under Chapter XI of the Bankruptcy Act.

2. In failing to hold that interest on tax claims of the United States should be allowed after the date of the filing of the petition for an arrangement and until the taxes are paid or otherwise satisfied.

3. In affirming the order of the District Court.

SUMMARY OF ARGUMENT

A. The rule stopping interest on claims generally at bankruptcy does not apply to arrangement proceedings under Chapter XI of the Bankruptcy Act. While appropriate to assure fair distribution in a liquidation proceeding, this rule is inapplicable to a rehabilitation proceeding, where the business is continued as a going concern. An arrangement proceeding is essentially a reorganization tailored to meet the needs of small business. Thus, for the reasons pointed out in the Govern-

ment's brief in *United States* v. *Edens*, No. 299, this Term, the rule of *New York* v. *Saper*, 336 U. S. 328, is as inappropriate to Chapter XI as it is to Chapter X. Where no receiver or trustee is appointed, the debtor continues in possession of his property subject to court control. During this period, the estate should pay interest as compensation for the use made of assets owing to others. Nor does allowance of interest in arrangement proceedings result in administrative inconvenience.

B. Indeed, although the nature of the proceedings provides a basis for allowing interest on all debts, there is an additional reason for requiring the payment of interest on debts entitled to priority, such as taxes. The absolute priority rule governs arrangement proceedings under Chapter XI and requires that creditors receive full compensatory treatment for interest claims before claimants of a junior class receive anything. Moreover, since interest is permitted to run on all debts not covered by the arrangement (*i. e.*, secured debts), clearly it should not be cut off with respect to federal tax claims, the payment of which is guaranteed by a special deposit. To deny interest on tax claims while permitting the debtor, as here, to continue in ownership of a portion of his estate and business, runs directly counter to the absolute priority rule, and even violates the accepted rule in bankruptcy, that priority creditors should not be required to surrender part of their claims, while the debtor retains a portion of his property.

C. The pertinent provisions of Chapter XI support the running of interest during arrangement. The Bankruptcy Act provisions, to which this Court in *New York* v. *Saper, supra,* pointed as indicating the Congressional intent to assimilate taxes to other debts in bankruptcy proceedings, are inapplicable in Chapter XI proceedings, either expressly or by implication. Since interest is not cut off on claims generally in Chapter XI proceedings, there is no basis for treating federal claims for unpaid taxes as inferior.

ARGUMENT

In an Arrangement Proceeding Under Chapter XI of the Bankruptcy Act, the United States Is Entitled to Interest on Unpaid Taxes for the Period Following the Date of the Filing of the Petition for Arrangement.

The Internal Revenue Code provides that if social security and withholding taxes are not paid when due, there shall be added as part of the tax interest at the rate of six per cent until the tax is paid. Internal Revenue Code, Sections 1420(b), 1605(b) and 1627, set forth in the Appendix, *infra*, p. 21.[1] In this case, the court below refused

[1] A review of the legislative background of the comparable provision applicable to income taxes indicates a general Congressional intent to impose the requirement that interest be paid on an insolvent estate vested in the hands of a trustee. See pp. 13 to 17 of petitioner's brief in *United States* v. *Bloom*, No. 100, filed at the same time as this brief. This argument was submitted to this Court in the *Saper* case, but the Court indicated that the specific intent with respect to cutting off interest in straight bankruptcy proceedings was controlling. See *New York* v. *Saper*, 336 U. S. 328, fn. 18, at 340-341.

to permit payment of any part of the statutory interest which accrued subsequent to the date of the filing of a petition for arrangement under Chapter XI of the Bankruptcy Act, Act of June 22, 1938 (Chandler Act), 52 Stat. 840, 905, 11 U. S. C. 701 *et seq.* The court's decision (R. 27, 29) was squarely based on this Court's opinion in *New York* v. *Saper*, 336 U. S. 328, which denied the Government the right to interest accruing during the course of a straight bankruptcy proceeding.

It is the Government's view that reliance of the court below on the decision of this Court in *New York* v. *Saper*, *supra*, is misplaced for substantially the same reasons set forth in our brief in *United States* v. *Edens*, No. 299, involving Chapter X proceedings, to be argued immediately before this case.

The court below denied the Government's claim to post-petition interest on the assumption that Chapter XI proceedings are a kind of bankruptcy in which creditors have the same rights as in straight bankruptcy; that (R. 28): "In an arrangement proceeding under Chapter XI the 'debtor' is virtually a bankrupt except in name." This view was also adopted by the majority of the Court of Appeals for the First Circuit in *Massachusetts* v. *Thompson*, 190 F. 2d 10, petition for certiorari pending, No. 368, this Term, expressly following the reasoning in the opinion below with respect to the *Saper* case. In the Government's view, however, differences in the purposes and ef-

fects of bankruptcy proceedings, on the one hand, and arrangement proceedings under Chapter XI, on the other, are so fundamental that the reasoning underlying the *Saper* case itself would require that interest continue to accrue in Chapter XI cases rather than that it be cut off. Judge Woodbury's dissent in the *Thompson* case, *supra*, pp. 11-12, directly sustains the Government's position here, as does the reasoning of the District Court with respect to a Chapter X proceeding in *In re Lexington Homes*, 94 F. Supp. 482 (D. N. J.).

A. *There are such fundamental differences between straight bankruptcy and Chapter XI proceedings, that the application of the bankruptcy rule is inappropriate in Chapter XI.*—The basis for the holding in the *Saper* case was that, in straight bankruptcy, interest ceases to run on debts other than taxes from the date the petition is filed, and that Congress had, in amendments to the Bankruptcy Act, evinced an intention to assimilate federal tax claims to other debts. See *New York* v. *Saper*, *supra*, pp. 337-338. But the general rule stopping interest at bankruptcy, in light of which this Court read the 1926[2] and Chandler Act amendments to Chapters I to VII of the Bankruptcy Act, is not appropriate in arrangement proceedings for corporate reorganization.

Like Chapter X, Chapter XI is not an instrument for liquidating insolvent debtors and dis-

[2] Act of May 27, 1926, c. 406, 44 Stat. 662, 666, Sec. 15.

tributing their assets.[3] The primary purpose of the arrangement proceeding is rehabilitation, applicable especially to "small individual or corporate business where there are no public or private interests involved requiring protection by the procedure and remedies afforded by Chapter X." *Securities Comm'n* v. *U. S. Realty Co.*, 310 U. S. 434, 448, 454.[4] Chapter XI provides "a summary procedure" (*id.* 446), by which a debtor may secure judicial confirmation for the settlement, satisfaction, or extension of the time of payment of his unsecured debts upon any terms. Section 306(1) (11 U. S. C. 706(1), Appendix, *infra*, p. 24). The unsecured debts may be treated generally or in classes. Sections 356, 357 (11 U. S. C. 756, 757, Appendix, *infra*, p. 26). However, no alteration may be made of the rights of secured creditors or of the various classes of stockholders. The procedure is available upon mere inability to pay debts when they mature (Section 323 (11

[3] Chapter XI is derived from Section 12 of the old Bankruptcy Act, enlarged by Section 74 added by the Act of March 3, 1933, c. 204, 47 Stat. 1467, Sec. 1. Old Section 12 was always considered as something apart from bankruptcy since its object was to revert his property to the debtor free from creditors' claims. *Cumberland Glass Co.* v. *DeWitt*, 237 U. S. 447, 453-454; *Nassau Works* v. *Brightwood Co.*, 265 U. S. 269.

[4] Section 12 of the old bankruptcy act differed materially from Chapter XI in that it did not incorporate the "fair and equitable" standard. See *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, fn. 14, at 119-120.

U. S. C. 723), Appendix, *infra*, p. 25), and is not dependent upon insolvency in the bankruptcy sense (Section 1 (19); 11 U. S. C. 1(19)). An arrangement proceeding is essentially a reorganization proceeding tailored to meet the needs of small business.[5]

The institution of an arrangement proceeding rests in the volition of the debtor alone; there is no

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[5] In recommending Chapter XI, the House Committee said (H. Rep. No. 1409, 75th Cong., 1st sess., pp. 50-51):

> The scope of the proposal has been expanded so that it may include any terms and be made upon any consideration, subject to approval by the court as fair, equitable, and in the interests of creditors. The unsecured creditors may be divided into classes, and the proposal may deal with all or any of these classes in different ways; and in such event each class votes separately. Provision is made for the rejection of contracts, executory in whole or in part, including unexpired leases of real or personal property. Debts which are incurred during the pendency of the arrangement may be given priority of payment over debts affected by the arrangement. The debtor may be continued in possession of his property during the pendency of the proceeding and also during the period of the arrangement. A general provision is inserted which permits any other appropriate terms not inconsistent with the section. In several respects the proceeding has been speeded up.
>
> We believe that the section as rewritten has been made sufficiently flexible to permit the offer of a settlement in a variety of situations not now covered either by section 12 or by section 74. The inclusion of corporations will permit a large number of the smaller companies such as are now seeking relief under section 77B but do not require the complex machinery of that section, to resort to the simpler and less expensive, though fully adequate, relief afforded by section 12.

provision for filing an involuntary petition. Sections 321 and 322 (11 U. S. C. 721 and 722). Indeed, when no receiver or trustee is appointed, the debtor continues in possession of his property, exercising all the powers of a trustees subject to court control. Section 342 (11 U. S. C. 742).

As is pointed out in petitioner's brief in *United States* v. *Edens*, No. 299, this Term, at pages 12 to 14, the estate of a debtor in reorganization does not, on the filing of the petition, become a "dead fund" making it inequitable to require interest on debts which have remained unpaid by reason of court orders. On the contrary, the business of the debtor is carried on, frequently under the continued control of the debtor, until the arrangement can be completed. It does not seem inequitable that the estate which has continuing use of money owed to another should continue to pay for the use of that money.

Nor does the need for continuous recomputation of interest (*Vauston Committee* v. *Green*, 329 U. S. 156, 164; *New York* v. *Saper*, 336 U. S. 328, 334) have the same impact in a Chapter XI proceeding that it does in bankruptcy. As pointed out in the Government's brief in the *Edens* case, the difficulty in bankruptcy arises from the fact that creditors' claims are met by dividends paid from time to time as the assets are liquidated. In Chapter XI, on the other hand, priority debts are met out of a deposit required to be made at a time fixed by the

court under Section 337(2) of the Act (11 U. S. C. 737(2), Appendix, *infra*, pp. 25-26). Any payments to other creditors made under the adjustment are by the same section required to be made a part of the same deposit. Upon confirmation of the arrangement, the deposit is distributed. Section 367(2) and (3) (11 U. S. C. 767(2) and (3), Appendix, *infra*, pp. 27-28). Thus, the basis for cutting interest off as of the time of the petition as a matter of convenience is not applicable to these proceedings.

B. *The absolute priority rule requires that creditors, including the United States, receive full compensatory treatment for interest claims made the subject of an arrangement proceeding.*—As with Chapter X reorganizations, a condition for confirmation of an arrangement under Chapter XI is that the plan be "fair and equitable." (Section 366(3) (11 U. S. C. 766(3), Appendix, *infra*, p. 27). These "words of art," possessing well-understood meaning in reorganization proceedings, have repeatedly been held to require absolute priority. *Securities Comm'n* v. *U. S. Realty Co.*, *supra*, p. 452; *Mecca Temple, etc.* v. *Darrock*, 142 F. 2d 869 (C. A. 2), certiorari denied, 323 U. S. 784; 8 Collier on *Bankruptcy* (14th ed. 1941), pp. 1187-1195. In a reorganization proceeding, a creditor's claim to interest up to the date of payment is considered one of the rights to which his priority attaches. *Consolidated Rock Co.* v. *DuBois*, 312

U. S. 510, 527-530. Thus, with respect to claims entitled to priority, the absolute priority rule requires in Chapter XI, as in Chapter X, that interest to the date of payment be paid before junior claimants participate. (See Petitioner's brief in *United States* v. *Edens*, No. 299, this Term, pp. 15-18.)

Unpaid federal taxes are given a priority in Chapter XI proceedings. If the debtor is insolvent, the Government's claim for taxes is entitled to priority under the provisions of Section 3466 of the Revised Statutes (31 U. S. C. 191, Appendix, *infra*, p. 29), which since 1797 have required that federal taxes must be paid first out of the estate of an insolvent. But even in the absence of insolvency, the Bankruptcy Act itself provides a priority. Section 302 (11 U. S. C. 702) incorporates into Chapter XI those provisions of Chapters I to VII which are not inconsistent with its terms. Therefore, those debts given priority in straight bankruptcy by Section 64(a) (11 U. S. C. 104(a)) must be considered as having priority in Chapter XI, although the order of priority is not significant since Section 337(2) requires a deposit sufficient to meet in full all of the debts entitled to priority. See 8 Collier on *Bankruptcy*, pp. 531, 534. Taxes due the United States are given a priority by Section 64(a). The special deposit provisions of Section 337 are therefore applicable, and taxes due to the United States are treated as something apart from claims to be adjusted under the provisions of

Chapter XI. In this sense, then, unpaid taxes are treated as something above other claims, in much the same manner as they were in straight bankruptcy before amendments to the Bankruptcy Act terminated their privileged status. Compare *In re Kallak*, 147 Fed. 276 (D. N. D.). Since unpaid taxes do have the status of prior claims, it follows that one of the bundle of rights that must be satisfied in order that a plan of arrangement can be held "fair and equitable" is the right to interest to the time of payment.

The adjustment which has been approved by the creditors and confirmed by the court in this very case illustrates the unreasonableness of disallowing the Government's claim for interest. The plan provides, after setting up a deposit for small claims and those having priority, and after surrendering certain assets to a liquidating corporation for the benefit of creditors, that inventory not to exceed $135,000 as well as certain patents and other assets shall be retained by the debtor. The debtor contracts with other tool manufacturing companies to manufacture machine tools under its patents and in the process uses up the machine tool inventory retained (R. 26). Such a plan is quite within the purposes of Chapter XI, which, as is pointed out above, is intended as a means of rehabilitating the debtor. But it is not in accord with the accepted rule even in straight bankruptcy that creditors should be required to surren-

der interest up to the date of payment if the debtor is revested with a portion of his estate. Cf. *American Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 266-267; *New York* v. *Saper, supra*, p. 330, fn. 7. As Judge Woodbury stated in his dissent in *Massachusetts* v. *Thompson*, 190 F. 2d 10, at 12:

> * * * in view of the fact that interest is entitled to the same priority as principal, * * * to deny interest on the Commonwealth's tax claim while permitting the debtor to continue in the ownership of its property and the control of its business would be to subordinate the rights of a priority creditor to the interest of the owners of the business, in this case stockholders, and thus run directly counter to the "absolute priority" rule.

Hence, we submit that the balance of the equities which this Court, in *Vanston Committee* v. *Green, supra*, p. 165, held to constitute the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization proceedings, requires the allowance of interest here for the period between the date of the petition and the date the taxes were paid.

C. The pertinent provisions of Chapter XI support the running of interest.—This Court found in *New York* v. *Saper*, 336 U. S. 328, 337-338, that Congress had intended by the 1926 and Chandler Act amendments to the Bankruptcy Act, read in

conjunction with the general rule against post-bankruptcy interest, to assimilate taxes to other debts. Specifically, the Court referred to Section 57(n) (11 U. S. C. 93(n)), which requires the Government to file proof of its claims as do other creditors, to Section 64(a) (11 U. S. C. 104(a)), which reduces the priority status of claims for federal taxes, and to Section 63(a)(1) and 63(a)(5) (11 U. S. C. 103(a)(1) and 103(a)(5)), which terminate interest on certain types of claims on the date of the petition. These sections are directly applicable only to bankruptcy proceedings. However, Section 302 (11 U. S. C. 702, Appendix, *infra*, pp. 23-24) incorporates by reference such provisions of the first seven chapters of the Act as are not inconsistent with the provisions of Chapter XI. The application of the sections mentioned to Chapter XI proceedings is, however, so limited as to lose all significance as an indication of Congressional intent to assimilate taxes to other debts.

Except in the particular instance where a debtor files a petition under Chapter XI in a pending bankruptcy proceeding after the time for filing claims in the bankruptcy proceeding has expired (Sections 321, 354; 11 U. S. C. 721, 754), the time within which proofs of claim may be filed in a Chapter XI proceeding clearly is not governed by Section 57(n). The six months' limitation of Section 57(n) is inconsistent with the provisions of Sections 367(3), 369 and 370 (11 U. S. C. 767(3),

769, 770), which permit proofs of claims to be filed in a Chapter XI proceeding at any time prior to the date of confirmation of the arrangement. 8 Collier, *supra*, pp. 967-970. Moreover, a creditor participates in the distribution of the consideration whether or not proof has been filed, if his claim is scheduled by the debtor as a fixed liability, liquidated in amount, and not disputed. Section 367(3). Cf. *Nassau Works* v. *Brightwood Co.*, *supra*.

Further, so far as Chapter XI proceedings are concerned, the hierarchy of priorities specified in Section 64(a), under which tax claims are relegated to the fourth priority, is inapplicable, since pursuant to Section 337(2) the prescribed deposit must be made sufficient to pay all priority debts. See 8 Collier on *Bankruptcy*, 534.

Again, under Section 307 (11 U. S. C. 707, Appendix, *infra*, pp. 24-25), which applies to an arrangement proceeding for an extension of time for payment of debts in full, "debts" include all unsecured debts, demands or claims of whatever character, whether or not provable as debts under Section 63, and whether liquidated or unliquidated, fixed or contingent.

Moreover, the concept of payment and declaration of dividends in straight bankruptcy prescribed by Section 65 (11 U. S. C. 105) differs entirely from the concept of participation by unsecured creditors and stockholders in a rehabilitated

debtor under the plan of arrangement, pursuant to Sections 367(3) and 370. There is no provision in Chapter XI dealing with dividends, since the primary purpose of the proceeding is not to liquidate but to rehabilitate.

In any event, the main point of the *Saper* case is that so far as interest is concerned, tax claims are to receive the same treatment as claims of other creditors—certainly not less favorable treatment. Read in this context and in view of the treatment accorded secured creditors, the provisions of Sections 57(n), 63(a) and 64(a), so far as applicable to Chapter XI proceedings, do not require denial of post-petition interest on priority claims of any creditor, including the United States.

Certainly the allowance of interest is strongly indicated when a plan can be worked out under which, as here, stockholders of the debtor are permitted to retain their investment, an eventuality which is, indeed, the primary purpose of Chapter XI.

CONCLUSION

The decision of the Court of Appeals for the Eighth Circuit should be reversed.

Respectfully submitted,

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DECEMBER, 1951

DARK PAGE BLEED THRU

APPENDIX

Internal Revenue Code:

SEC. 1420. (26 U.S.C. 1420.) COLLECTION AND PAYMENT OF TAXES.

* * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411) at the rate of 6 per centum per annum from the date the tax became due until paid.

* * *

SEC. 1605. (26 U.S.C. 1605.) PAYMENT OF TAXES.

* * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 6 per centum per annum from the date the tax became due until paid.

SEC. 1627 [as added by the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 2]. (26 U.S.C. 1627.) OTHER LAWS APPLICABLE.

All provision of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

Bankruptcy Act, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

> SEC. 64 [As further amended by the Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12 and Act of May 24, 1949, c. 139, 63 Stat. 89, Sec. 131]. (11 U. S. C., Supp. IV, 104). DEBTS WHICH HAVE PRIORITY. a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages not to exceed $600

to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of Title 18 of the United States Code, the reasonable cost and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; * * *.

CHAPTER XI—ARRANGEMENTS

* * *

SEC. 302. (11 U.S.C. 702.) The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy pro-

ceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act, and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered.

SEC. 306. (11 U.S.C. 706.) For the purposes of this chapter, unless inconsistent with the context—

(1) "arrangement" shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms;

* * *

(3) "debtor" shall mean a person who could become a bankrupt under section 4 of this Act and who files a petition under this chapter;

* * *

(5) "petition" shall mean a petition filed under this chapter by a debtor proposing an arrangement.

SEC. 307. (11 U.S.C. 707.) Unless inconsistent with the context and for the purposes of an arrangement providing for an extension of time for payment of debts in full and applicable exclusively to the debts to be extended—

(1) "creditors" shall include the holders of all unsecured debts, demands, or claims of

whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent; and

(2) "debts" or "claims" shall include all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent.

SEC. 323. (11 U.S.C. 723.) A petition filed under this chapter shall state that the debtor is insolvent or unable to pay his debts as they mature, and shall set forth the provisions of the arrangement proposed by him.

SEC. 337. (11 U.S.C. 737.) At such meeting, or at any adjournment thereof, the judge or referee shall, after the acceptance of the arrangement—

* * *

(2) fix a time within which the debtor shall deposit, in such place as shall be designated by and subject to the order of the court, the consideration, if any, to be distributed to the creditors, the money necessary to pay all debts which have priority, unless such priority creditors shall have waived their claims or such deposit, or consented in writing to any provision of the arrangement for otherwise dealing with such claims, and the money necessary to pay the costs and expenses of the proceedings and the actual and necessary expenses incurred in connection with the proceedings and

the arrangement by the committee of creditors and the attorneys or agents of such committee, in such amount as the court may allow; * * *

SEC. 356. (11 U.S.C. 756.) An arrangement within the meaning of this chapter shall include provisions modifying or altering the rights of unsecured creditors generally or of some class of them, upon any terms or for any consideration.

SEC. 357. (11 U.S.C. 757.) An arrangement within the meaning of this chapter may include—

(1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms;

(2) provisions for the rejection of any executory contract;

(3) provisions for specific undertakings of the debtor during any period of extension provided for by the arrangement, including provisions for payments on account;

(4) provisions for the termination, under specified conditions, of any period of extension provided by the arrangement;

* * *

SEC. 366. (11 U.S.C. 766.) The court shall confirm an arrangement if satisfied that—

(1) the provisions of this chapter have been complied with;

(2) it is for the best interests of the creditors;

(3) it is fair and equitable and feasible;

(4) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

(5) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act.

SEC. 367. (11 U.S.C. 767.) Upon confirmation of an arrangement—

(1) the arrangement and its provisions shall be binding upon the debtor, upon any person issuing securities or acquiring property under the arrangement and upon all creditors of the debtor, whether or not they are affected by the arrangement or have accepted it or have filed their claims, and whether or not their claims have been scheduled or allowed and are allowable;

(2) the money deposited for priority debts and for the costs and expenses shall be disbursed to the persons entitled thereto;

(3) the consideration deposited, if any, shall be distributed and the rights provided by the arrangement shall inure to the creditors affected by the arrangement whose claims are not barred by the provisions of section 354 of this Act, and (a) have been proved prior to the date of confirmation and are allowed, or

(b) whether or not proved, have been scheduled by the debtor as fixed liabilities, liquidated in amount, and are not disputed; and

(4) except as otherwise provided in sections 369 and 370 of this Act, the case shall be dismissed.

SEC. 394. (11 U.S.C. 794.) The clerk and, in the case of a reference, the referee after such reference, shall forthwith transmit to the Secretary of the Treasury copies of—

(1) all petitions filed under sections 321 and 322 of this Act;

(2) all notices given in a proceeding under this chapter;

(3) all orders dismissing proceedings or directing that bankruptcy be proceeded with, discharging debtors, closing estates, and setting aside confirmations;

(4) all orders appointing receivers or continuing debtors in possession;

(5) all orders confirming arrangements, together with copies of such arrangements;

(6) all orders approving alterations or modifications in arrangements, together with copies of such alterations or modifications;

(7) all applications for allowances for compensation and expenses, and the orders making or refusing to make such allowances; and

(8) such other papers filed in the proceedings as the Secretary of the Treasury may re-

quest or which the court may direct to be transmitted to him.

Any order fixing the time for confirming an arrangement which affects claims of the United States shall include a notice to the Secretary of the Treasury of not less than fifteen days.

SEC. 397. (11 U.S.C. 797.) Any provision in this chapter to the contrary notwithstanding, all taxes which may be found to be owing to the United States or any State from a debtor within one year from the date of the filing of a petition under this chapter, and have not been assessed prior to the date of the confirmation of an arrangement under this chapter, and all taxes which may become owing to the United States or any State from a receiver or trustee of a debtor or from a debtor in possession, shall be assessed against, may be collected from, and shall be paid by the debtor or the corporation organized or made use of for effectuating an arrangement under this chapter: *Provided, however,* That the United States or any State may in writing accept the provisions of any arrangement dealing with the assumption, settlement, or payment of any such tax.

Revised Statutes:

SEC. 3466. (31 U.S.C. 191.) Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due

from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

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No. 300.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1951.

UNITED STATES OF AMERICA,
Petitioner,

v.

GENERAL ENGINEERING AND MANUFACTURING COMPANY, a Corporation,
Debtor.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit.

BRIEF FOR THE RESPONDENT.

GEORGE C. WILLSON,
Attorney for Respondent.

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BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The memorandum opinions of the referee in bankruptcy (R. 8-14) and of the District Court (R. 19-22) are unreported. The opinion of the Court of Appeals (R. 25-29) is reported in 188 F. 2d 80.

JURISDICTION.

The judgment of the Court of Appeals was entered on April 11, 1951 (R. 29). By order of Chief Justice Vinson, dated July 3, 1951 (R. 31), the time within which a petition for a writ of certiorari might be filed was extended to and including September 8, 1951. The petition for a writ of certiorari was filed September 4, 1951, and was granted on November 5, 1951 (R. 32). The jurisdiction of this Court rests on the provisions of 28 U. S. C. 1254.

QUESTION PRESENTED.

Whether, in an arrangement proceeding under Chapter XI of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for arrangement.

STATUTES INVOLVED.

The pertinent statutory provisions are printed in the Appendix, infra, page 19.

STATEMENT.

The statement of the material facts contained in Petitioner's brief is accurate and satisfactory to Respondent.

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SUMMARY OF ARGUMENT.

A. The Saper case holds that the general rule stopping the running of interest when the petition is filed is applicable to tax claims, as well as to all others. This same general rule controls the running of interest on all claims in this Chapter XI proceeding, for the provisions of Chapters I to VII of the Bankruptcy Act which were held in the Saper case to cut off interest in bankruptcy are applicable to this Chapter XI proceeding, and there is no evidence in Chapter XI of an intention to favor tax claims in this respect. The arguments made by the Government on the basis of Section 337 (2) of Chapter XI and on the basis of cases arising under Chapter X serve to accentuate the applicability of the Saper decision to the present case. Section 337 (2) derives its potency from and is limited by Sections 63 (a) and 64 (a), both of which sections were interpreted in the Saper case as embodying the general rule cutting off interest at the time of filing of the petition. Chapter X specifically excludes from its operation both Sections 63 (a) and 64 (a), thereby emphasizing the essential differences between these two separate statutory procedures.

B. There are several reasons why the rule of absolute priority does not require that the Government receive post-petition interest on its tax claims in this arrangement proceeding. First, there is question of the applicability of the rule to Chapter XI; it is not clear from the statements of the originators of the Chapter that it was intended to apply, and its application is likely to hinder the effectuation of the purpose of the Chapter—the rehabilitation of debtors in financial difficulties. Second, if the rule has any application to Chapter XI it can operate only to the advantage of the entire group of general creditors as against the debtor, and not to favor

some general creditors over others. Certain categories of claims, including taxes, enjoy a **limited** priority over the other general creditors, but for purposes of the application of the absolute priority rule there is only one class of creditors involved in Chapter XI, the general creditors. Third, the rule can have no application to post-petition interest in a Chapter XI settlement arrangement, since Section 63 (a) denies to all claimants therein the right to such interest, and the absolute priority rule does not purport to create rights, but only to protect them. And, fourth, regardless of the degree of applicability of the absolute priority rule to Chapter XI, the arrangement which was proposed and confirmed in the proceeding out of which this case arose would not constitute a violation of it. The rule requires only that the debtor contribute for what it retains and the debtor contribute in full for all that it received under the arrangement.

C. Contrary to the assertion made by the Government, the equitable considerations are all opposed to the granting of post-petition interest on these tax claims. No other creditor received post-petition interest. The Government would receive it at the expense of general creditors who have not, and will not, receive payment of the principal amount of their claims, and a ruling that the absolute priority rule requires payment of post-petition interest on claims in Chapter XI would create an inequitable situation, since some of these claims bear interest and some do not.

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ARGUMENT.

In a Proceeding for an Arrangement Under Chapter XI of the Bankruptcy Act, the United States Is Entitled to Interest on Its Tax Claims Only to the Date of the Filing of the Arrangement Petition.

The Government is asserting a right to post-petition interest on its tax claims. The burden of proving a right to priority is on the claimant. Matter of Paradise Catering Corp., 36 F. Supp. 974; 3 Collier on Bankruptcy (14th ed.), Par. 64.701, p. 2189. In an effort to sustain this burden the Government has placed reliance on two Sections of Chapter XI, Section 337 (2) [11 U. S. C. 737 (2), Appendix, infra, p. 23], which requires the debtor to deposit the money necessary to pay all debts which have priority, and Section 366 (3) [11 U. S. C. 766 (3), Appendix, infra, p. 25], which requires that the arrangement be fair and equitable. The Government has also made a general assertion that there are fundamental differences between straight bankruptcy and Chapter XI proceedings, which sustain their right to post-petition interest. However, we believe that where the legislative scheme is as comprehensive and as detailed as Chapter XI, there is little room for generalities, particularly where they tend to controvert the language of specific provisions.

A. The provisions of Chapters I to VII and Chapter XI of the Bankruptcy Act show a Congressional intention to cut off interest on tax claims at the filing of a Chapter XI petition.

In City of New York v. Saper, 336 U. S. 328, the issue was whether in a bankruptcy proceeding tax claims draw interest only to the date of filing of the petition or until paid. That non-tax claims, even priority claims, are subject to the English rule stopping interest when the petition

is filed was already well established (New York v. Saper, supra, pp. 330, 331), but the Government argued that its tax claims were exempt from this general rule. The Supreme Court concluded that there was no basis for such an exemption. As is accurately stated by counsel for the Government in their brief at page 9: "The basis for the holding in the Saper case was that, in straight bankruptcy, interest ceases to run on debts other than taxes from the date the petition is filed, and that Congress had, in amendments to the Bankruptcy Act, evinced an intention to assimilate federal tax claims to other debts."

The present case arose out of a Chapter XI proceeding, but in the determination of the Government's asserted right to post-petition interest on its tax claims the Saper decision is of great significance. We believe that the Government is in error in its assertions in paragraphs A and C of the Summary of Argument in their brief to the effect that the rule stopping interest on claims generally when the petition is filed does not apply to arrangement proceedings under Chapter XI. On the contrary, it can be demonstrated that this general rule regarding cessation of interest is applicable to the present Chapter XI case, and that in consonance with the Saper decision, this rule governs all claims, including those for federal taxes. Certainly the Saper case, which involved an interpretation of the provisions of Chapters I to VII of the Bankruptcy Act, is a clear ruling that those provisions deny to the Government, as well as to all other claimants, the right to post-bankruptcy interest. Sections 302 and 352 of Chapter XI (11 U. S. C. 702 and 752, Appendix, infra, pp. 22, 24) provide that where not inconsistent with the provisions of Chapter XI, the provisions of Chapters I to VII shall apply, and the rights, duties and liabilities of creditors with respect to the property of the debtor shall be the same as if a voluntary petition for adjudication had been filed at the time the petition under Chapter XI was filed. These sections,

particularly the latter, with its specific reference to the like effect of the filing of a Chapter XI petition to the filing of a voluntary petition for adjudication in bankruptcy, place squarely on the Government the heavy burden of establishing the inconsistency with Chapter XI of the provisions of Chapters I to VII which the Saper case held to show a Congressional intention to deny post-bankruptcy interest on tax claims. We believe that this burden cannot be sustained and that the Government, in its efforts to do so, has accentuated the applicability to this Chapter XI proceeding of the provisions of Chapters I to VII considered so important and controlling in the Saper case, namely, Sections 57 (n) [11 U. S. C. 93 (n)], 63 (a) and 64 (a) [11 U. S. C. 103 (a) and 104 (a), Appendix, infra, pp. 19, 20, 21].

The Government has asserted that the provisions of Section 337 (2) of Chapter XI entitle tax claims to interest until paid. A close analysis of this section shows the assertion to be unsound, for it requires only that the debtor shall deposit the money necessary to pay all **debts** which have **priority**. The controlling words are not defined in the section. But it can be illustrated that for the purposes of the present proceeding neither of these important terms is sufficiently broad to include post-petition interest on tax claims. In fact, each term derives its meaning from, and is limited by, a section of Chapters I to VII construed in the Saper case to show an intention to stop the running of interest on all claims, "debts" by Section 63 (a) and "priority" by Section 64 (a).

The only definition of "debts" contained in Chapter XI appears in Section 307 (2) [11 U. S. C. 707 (2), Appendix, infra, p. 23]: "'Debts' or 'claims' shall include all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent." But this definition of "debts"

is specifically limited to an arrangement providing for an extension of time for payment of debts in full and has no application to the present arrangement which was a settlement or satisfaction and not an extension (R. p. 9).

There is apparent in the 307 (2) definition of "debts" the clearest indication that where the arrangement takes the form of a settlement or satisfaction of unsecured debts, Section 63 shall govern the determination of what are "debts." The soundness of this proposition is fortified by the fact that "debts" is defined in Section 1 (14) of Chapter I [11 U. S. C. 1 (14), Appendix, infra, p. 19] to include "any debt, demand or claim provable in bankruptcy." No inconsistency appearing between this definition and the provisions of Chapter XI governing a settlement arrangement, the definition applies to such a proceeding by virtue of Section 302 (11 U. S. C. 702, Appendix, infra, p. 22) of that chapter. 8 Collier on Bankruptcy (14th ed.), Pars. 2.20-2.23, pp. 65-71. Debts provable in bankruptcy are set forth in Section 63 (11 U. S. C. 103, Appendix, infra, p. 19). It therefore becomes important to determine whether post-petition interest constitutes a debt provable under Section 63, since this Section controls the scope of the word "debts" as it appears in Section 337 (2) of Chapter XI where the arrangement constitutes a settlement or satisfaction. 8 Collier on Bankruptcy (14th Ed.), Par. 7.05, pp. 945-950. That post-petition interest is not provable and allowable under Section 63 is apparent. Two subdivisions of that Section, 63 (a) (1) and 63 (a) (5), specifically negate any right to post-petition interest, and the Section has been held to reflect the English rule stopping interest on claims as of the date of the filing of the petition. New York v. Saper, supra, pp. 330-332.

The term "priority" which also appears in Section 337 (2) is not defined in Chapter XI and the Government agrees, as indeed they must, that this Section incorporates into Chapter XI the priority system contained in Section

64 (a) [11 U. S. C. 104 (a), Appendix, infra, p. 20]. The derivation of this priority, which extends to five broad categories of debts, including taxes, is of considerable importance since the Government has sought to establish[1] that it constitutes absolute priority. The assertions made in the Government's brief find no justification in the Statute. Whatever priority tax claims enjoy by virtue of Section 64 (a) is not unique but is shared equally with a number of other categories of claimants.

In addition, the priority granted by Section 64 (a) is clearly limited in its scope and there is no indication in the language of Section 337 (2) of any intention to expand this scope for the purposes of Chapter XI. One of the principal limitations on Section 64 (a) priority is that it does not entitle its possessors to interest on their claims beyond the institution of the proceedings. Indeed, the inclusion of tax claims in Section 64 (a), in a position subordinate to certain categories which do not bear interest, was one of the considerations which led the Supreme Court to deny post-bankruptcy interest on tax claims in the Saper case. New York v. Saper, supra, p. 334. The Government, while anxious to claim the priority which Section 64 (a) accords to its tax claims, seeks to escape this limitation by emphasizing that the requirement of a deposit to assure payment of all priority debts renders inapplicable the hierarchy of priorities specified in Section 64 (a). But the deposit serves only to place all priority creditors on an equal footing and does not expand the scope of the limited priority borrowed from Section 64 (a).

---

[1] The following statements appear on pages 14 and 15 of the Government's brief: "Taxes due the United States are given a priority by Section 64 (a). The special deposit provisions of Section 337 are therefore applicable, and taxes due to the United States are treated as something apart from claims to be adjusted under the provisions of Chapter XI. In this sense, then, unpaid taxes are treated as something above other claims, in much the same manner as they were in straight bankruptcy before amendments to the Bankruptcy Act terminated their privileged status."

Thus, in a Chapter XI proceeding by way of settlement or satisfaction, Section 337 (2) grants no right to post-petition interest, even to priority creditors. The rights thereby granted are limited by the scope of the word "debts" and the extent of the "priority", neither of which is sufficiently broad to encompass post-petition interest. By invoking Section 337 (2) the Government unintentionally has illustrated the marked applicability of Sections 63 (a) and 64 (a) to proceedings under Chapter XI. The general rule stopping interest at the date of filing of the petition is thus fully applicable to such a proceeding and there is no evidence in Chapter XI of an intention to favor tax claims in this respect.

Nevertheless the Government has asserted that the application to Chapter XI of the sections of the Bankruptcy Act under consideration in the Saper case [Sections 57 (n), 63 (a) and 64 (a)] is "so limited as to lose all significance as an indication of Congressional intent to assimilate taxes to other debts" (page 17 of Petitioner's brief). The Referee, the District Court and the Court of Appeals have held the contrary to be true. The Government points out that the six months' limitation for filing claims contained in Section 57 (n) is inapplicable to Chapter XI, but this is not significant. The point made by the Saper case was that the Chandler amendment to Section 57 (n) "requires governmental claims to be proved in the same manner and within the same time as other debts . . ." New York v. Saper, supra, p. 332. With one exception, not material here, this is equally true of Chapter XI; Sections 367 (3), 369 and 370 of this Chapter are of general application. The Government is not bound by the six months' rule, but neither is any other Chapter XI creditor.

As pointed out above in the discussion of Section 337 (2), both Sections 63 (a) and 64 (a) of Chapters I to VII play an important part in Chapter XI. The system of limited priority erected by Section 64 (a) is transported

intact into Chapter XI by Section 337 (2), to determine which debts shall enjoy priority, and where the arrangement is a settlement or satisfaction of the debtor's unsecured debts, Section 63 (a) governs the determination of what are these debts. That these results were intended is strongly supported by the fact that Chapter XI was incorporated into the Bankruptcy Act by the Chandler Act of 1938, the identical legislation which contained the amendments to Sections 57 (n) and 64 (a) which "assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest." New York v. Saper, supra, pp. 337, 338.

In the course of their brief counsel for the Government place considerable reliance on interpretations and court decisions concerning Chapter X.[1] There are fundamental differences between these two statutory procedures (Securities Comm'n. v. U. S. Realty Co., 310 U. S. 434, 452) not only in nature and scope but also in the applicability of specific provisions of Chapters I to VII of the Bankruptcy Act. While the provisions of the Act which were analyzed in the Saper case are of great significance in Chapter XI settlement arrangements, governing such important considerations as which debts may be proved and allowed and which debts have priority, Sections 57 (n), 63 (a) and 64 (a) are all expressly stated to be inapplicable to reorganization proceedings under Chapter X. Unlike Chapter XI, Section 106 (6) [11 U. S. C. 506 (6)] of Chapter X defines "debts" as including all claims, and Section 106 (1) [11 U. S. C. 506 (1)] states that "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under Section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent.

1 "It is the Government's view that reliance of the court below on the decision of this Court in New York v. Saper, supra, is misplaced for substantially the same reasons set forth in our brief in United States v. Edens, No. 299, involving Chapter X proceedings, to be argued immediately before this case" (Page 8 of Petitioner's brief).

Thus the concept of a provable debt which is of such importance in straight bankruptcy and Chapter XI proceedings has no application whatever to a Chapter X reorganization. Section 102 of Chapter X (11 U. S. C. 502) provides that Section 64 shall not apply in Chapter X proceedings unless an order is entered directing that bankruptcy be proceeded with. Consequently the entire theory of limited priority contained in Section 64 (a), which is so carefully incorporated into Chapter XI via Section 337 (2) with its required deposit for payment of all debts which have this priority, is expressly excluded from Chapter X. That Congress intended a fundamental distinction between the theories of priority operative in Chapter X and Chapter XI is illustrated by statements contained in the Senate Hearings on H. R. 8046, 75 Cong., 2nd Sess. (1937, 1938) 77:

> "Section 64 of the general bankruptcy act, for example, provides for a fixed priority in the payment of claims. This section deals solely with unsecured claims, only unsecured claims being affected by bankruptcy. To apply it in corporate reorganizations—where secured as well as unsecured claims are dealt with—would cause great confusion. To make it clear that Section 64 does not apply, we propose this amendment which expressly provides that 64 shall not be applicable to Chapter X. The priorities under Chapter X would therefore be those used in equity receiverships. That is the present practice under 77B, which expressly provides that Section 64 shall not be applicable. When we adopt the same provision here we merely adopt the practice which is already in existence under Section 77B."

In view of these basic differences between Chapters X and XI in the applicability of the provisions of Chapters I to VII relating to debts which may be proved and debts which have priority, we believe that interpretations of

and cases decided under Chapter X and its predecessor, 77B, are of little assistance to the Government and serve to emphasize the applicability of the reasoning of this Court in the Saper case to arrangement proceedings under Chapter XI.

B. The rule of absolute priority does not require that the Government receive interest on its tax claims beyond the date of the filing of the arrangement petition.

The Government assumes that the absolute priority rule is fully applicable to Chapter XI proceedings. In support of this assumption reference is made to Section 366 (3) [11 U. S. C. 766 (3), Appendix, infra, p. 25], which requires the court to satisfy itself that the arrangement is fair and equitable as a condition precedent to confirmation. The Government also cites two cases, Securities Comm'n. v. U. S. Realty Co., 310 U. S. 434, and Mecca Temple etc. v. Darrock, 142 F. 2d 869 (C. A. 2), in support of its assertion that the words "fair and equitable" must be construed to require absolute priority. Perhaps these cases do require this unfortunate result. But it should be noted that in 1940, two years after the incorporation of the "fair and equitable" standard into Chapter XI, the members of the Supreme Court who heard the Securities Comm'n case were in disagreement as to its correct interpretation in Chapter XI. The intention of Congress in adopting the fair and equitable standard for Chapter XI, considered in light of the House Committee Report recommending Chapter XI,[1] seems to be in consonance with the statement by

[1] (H. Rep. No. 1409, 75th Cong., 1st Sess., pp. 50-51):

> The scope of the proposal has been expanded so that it may include any terms and be made upon any consideration, subject to approval by the court as fair, equitable and in the interests of creditors. The unsecured creditors may be divided into classes, and the proposal may deal with all or any of these classes in different ways; and in such event each class votes separately. Provision is made for the rejection of contracts, executory in whole or in part, including unexpired leases of real or personal property. Debts which are incurred during the pendency of the arrangement may be given priority of payment over debts affected by the arrangement. The debtor may be continued in possession of his property during the

Mr. Justice Roberts in his dissent to the decision in the Securities Comm'n case:

> Equally unavailing is the argument that the present case must belong under chapter X since secured creditors and stockholders must be brought into the reckoning and because one of the requirements of section 366 is that the court must find the arrangement is "fair and equitable and feasible." It is said that this phrase is a term of art, given meaning by our decision in Northern Pacific R. Co. v. Boyd, 228 U. S. 482, and that, within that meaning, no fair, equitable, and feasible plan can here be accomplished under chapter XI although it could be under chapter X.
>
> The short answer is that the phrase is used not only in chapter XI and chapter X but also in chapter XII respecting real property arrangements, and in chapter XIII respecting earners' plans. Obviously the phrase as used in the Chandler Act must be given the connotation appropriate to the section in which it is used.

Phraseology could scarcely be imagined which is less amenable to a strict and inflexible interpretation than "fair and equitable." The very essence of equity is that justice shall be done according to the circumstances of the particular case. To hold that the rule of absolute priority controls arrangement proceedings is to negate the flexibility which Congress intended to instill into Chapter XI (H. Rep. No. 1409, supra, pp. 50-51), and greatly to limit its availability to corporations and individuals in financial difficulties. This Court has not previously been asked to

pendency of the proceeding and also during the period of the arrangement. A general provision is inserted which permits any other appropriate terms not inconsistent with the section. In several respects the proceeding has been speeded up.

We believe that the section as rewritten has been made **sufficiently flexible** to permit the offer of a settlement in a variety of situations now covered either by Section 12 or by Section 74. The inclusion of corporations will permit a large number of the smaller companies such as are now seeking relief under section 77B but do not require the complex machinery of that section, to resort to the simpler and less expensive, though fully adequate, relief afforded by section 12. (Emphasis supplied.)

determine the extent of operation of the absolute priority rule in a case where the Chapter XI arrangement has been confirmed and consummated, since Securities Comm'n v. U. S. Realty Co., supra, involved only the question whether the District Court should have dismissed the petition for an arrangement.

Even if the absolute priority rule were considered applicable to Chapter XI, it could not operate in the manner urged by the Government. At the outside it could operate only to favor the general creditors over the debtor and its stockholders but the Government attempts to invoke it as against other general creditors. The attempt requires Petitioner's brief repeatedly to confuse two entirely different concepts of priority, one arising from Section 64 (a) [11 U. S. C. 104 (a)] and the other arising from Section 366 (3) [11 U. S. C. 766 (3)]. As previously demonstrated in this brief, Section 64 (a) grants a **limited** priority over other creditors to five categories of unsecured claims, including taxes, and this limited priority retains its limitations when it is brought into Chapter XI via the requirement in Section 337 (2) that the debtor deposit the money necessary to pay all priority debts. Therefore, so far as Section 337 (2) is concerned, federal tax claims, as priority claims, enjoy only a limited and not an absolute priority over other claimants. This limited priority, as previously pointed out, does not extend to post-petition interest. Likewise Section 366 (3) of Chapter XI cannot be construed to grant tax claims absolute priority over other general creditors, no matter how rigid a construction is placed on the phrase "fair and equitable". It should be emphasized that the federal tax claims involved here are general claims and that the Government is an unsecured creditor. As is stated in Securities Comm'n v. U. S. Realty Co., supra, p. 452, the absolute priority rule holds only that ". . . in any plan of corporate reorganization **unsecured creditors** are entitled to priority over **stockholders** to the full extent

of their debts and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of **stockholders** is inadmissible." (Emphasis supplied.)

Unsecured creditors as a group, then, might be held to enjoy absolute priority over stockholders. But only one category of claimants can be affected by a Chapter XI proceeding, those whose debts are unsecured. Section 306 (1) [11 U. S. C. 706 (1), Appendix, infra, p. 23]. While it is true that these unsecured debts may be treated on a parity, or divided into classes and treated differently (Sections 356, 357, 11 U. S. C. 756, 757, Appendix, infra, p. 24), these provisions are clearly permissive and negate the operation of the absolute priority rule in favor of one group of unsecured creditors over another. Thus it is clear that for purposes of the application of the rule there is only one class of claimants involved in a Chapter XI proceeding, and references in Petitioner's brief to "claimants of a junior class" (p. 6) and "junior claimants" (p. 14) are meaningless.

Irrespective of the extent of the application of the absolute priority rule to Chapter XI, it cannot protect for any claimant the right to post-petition interest in a settlement arrangement because, as previously demonstrated, no such right can exist. In a settlement arrangement Section 63 dictates which debts may be proved and allowed, 8 Collier on Bankruptcy (14th Ed.), Par. 7.05, pp. 945-950, and that section was held in the Saper case to embody the general rule stopping interest at the institution of the proceeding. See pages 330 and 331 of the opinion in that case. All that the absolute priority rule guarantees to unsecured creditors is that they are ". . . entitled to priority over stockholders to the full extent of their debts . . ." (Securities Comm'n v. U. S. Realty Co., supra, p. 452), and post-petition interest does not constitute a "debt" in a Chapter XI settlement arrangement.

Over and above these several impediments to the Government's argument that the absolute priority rule entitles tax claims to post-petition interest stands the important fact that the arrangement, which has long since been confirmed without objection thereto (R. 10), was both "fair and equitable," even restricting these words to the rigid meaning contended for by the Government. It is well to examine precisely what the absolute priority rule requires. It requires that the unsecured creditors receive compensation in full for their entire bundle of rights before the debtor is allowed to retain anything for which it does not contribute in money or money's worth. Case v. Los Angeles Lumber Co., 308 U. S. 106, 121, 122; Marine Properties v. Trust Co., 317 U. S. 78, 85. It does not require that the creditors be paid in full, regardless, nor does it prohibit the continued participation of the stockholders in the enterprise. It is well established that the stockholders of the debtor can retain an interest in the corporation provided they pay for what they retain. In the present case the debtor paid in full in money's worth for the shaper inventory which it retained, and no creditor did or had any cause to complain. The confirmation of the arrangement by the Referee in Bankruptcy was a judicial finding that it met the requirements of Section 366 and was fair and equitable. As is apparent from the Record (R. 10), no objections to debtor's arrangement were filed at any time prior to its confirmation and the arrangement was confirmed upon due notice to all parties in interest.

C. The equitable considerations pertinent to this proceeding are uniformly opposed to the position taken by the Government.

The Government has seen fit to submit at page 16 of its brief that ". . . the balance of the equities . . . requires the allowance of interest here for the period between the date of the petition and the date the taxes were paid." A number of factors argue forcefully against this

assertion. No other creditor received post-petition interest on any claims. Should the Government prevail it will receive post-petition interest at the expense of other general creditors who have not and will not receive repayment of even the principal amount of their claims. The only fund still under judicial control is the deposit made by the debtor for payment of priority claims. Any balance remaining in this deposit is to be paid to the liquidating corporation for the benefit of other general creditors (R. 10). Further, a holding that the absolute priority rule requires payment of interest on claims until date of payment would create an inequitable situation in Chapter XI, since some of the claims involved do and some do not bear interest. New York v. Saper, supra, p. 334. It would also appear that the Government's insistence on interest at 6% until paid, even though a Chapter XI petition has been filed, is inconsistent with the manifest purpose of the Chapter to rehabilitate debtors who are already in financial difficulties and are either bankrupt or cannot meet their debts as they mature.

Consequently the Respondent wishes to cite the Vanston case, supra, p. 165, believing that the balance of the equities in this case, both between the Government and the other creditors and between the former and the debtor, are heavily against the Government with regard to its demand for post-petition interest on tax claims.

CONCLUSION.

The decision of the Court of Appeals for the Eighth Circuit should be affirmed.

Respectfully submitted,

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January, 1952.

APPENDIX.

Bankruptcy Act of 1898, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

Sec. 1. **Meaning of Words and Phrases.** The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows:

* * * * * * *

(14) "Debt" shall include any debt, demand, or claim provable in bankruptcy (11 U. S. C., 1946 ed., Sec. 1).

Sec. 57. **Proof and Allowance of Claims.**—a. * * *

* * * * * * *

n. Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: Provided, however, that the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: Provided, further, that, except in proceedings under chapters X, XI, XII, and XIII of this Act, the right of infants and insane persons without guardians, without notice of the bankruptcy proceedings, may continue six months longer. * * * (11 U. S. C., 1946 ed., Sec. 93.)

Sec. 63. **Debts Which May Be Proved.** a. Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced

by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) costs taxable against a bankrupt who was at the time of the filing of the petition by or against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a provable debt; (4) an open account, or a contract express or implied; (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments; (6) an award of an industrial-accident commission, body, or officer of any State having jurisdiction to make awards of workmen's compensation in case of injury or death from injury, if such injury occurred prior to adjudication; (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; (8) contingent debts and contingent contractual liabilities; or (9) claims for anticipatory breach of contracts, executory in whole or in part, including unexpired leases of real or personal property.

* * * * * * *

(11 U. S. C., 1946 ed., Sec. 103).

Sec. 64. [As further amended by the Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12.] **Debts which have priority.** a. The debts to have prority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall

be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable cost and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; * * * (11 U. S. C., 1946 ed., Sec. 104.)

Chapter X—**Corporate Reorganization.**

* * * * * * *

Sec. 102. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: **Provided, however,** that section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive * * * (11 U. S. C., 1946 ed., Sec. 502).

Sec. 106. For the purposes of this chapter, unless inconsistent with the context—

(1) "Claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent; * * * (11 U. S. C., 1946 ed., Sec. 506).

Chapter XI—**Arrangements.**

* * * * * * *

Sec. 302. The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act,

and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of this Act except where an adjudication had previously been entered. (11 U. S. C., 1946 ed., Sec. 702.)

Sec. 306. For the purposes of this chapter, unless inconsistent with the context—

(1) "arrangement" shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms;

* * * * * * *

(11 U. S. C., 1946 ed., Sec. 706.)

Sec. 307. Unless inconsistent with the context and for the purposes of an arrangement providing for an extension of time for payment of debts in full and applicable exclusively to the debts to be extended—

(1) "creditors" shall include the holders of all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent; and

(2) "debts" or "claims" shall include all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent. (11 U. S. C., 1946 ed., Sec. 707.)

Sec. 337. At such meeting, or at any adjournment thereof, the judge or referee shall, after the acceptance of the arrangement—

* * * * * * *

(2) fix a time within which the debtor shall deposit, in such place as shall be designated by and subject to the order of the court, the consideration, if any, to be dis-

tributed to the creditors, the money necessary to pay all debts which have priority, unless such priority creditors shall have waived their claims or such deposit, or consented in writing to any provision of the arrangement for otherwise dealing with such claims, and the money necessary to pay the costs and expenses of the proceedings and the actual and necessary expenses incurred in connection with the proceedings and the arrangement by the committee of creditors and the attorneys or agents of such committee, in such amount as the court may allow:

* * * * * * *

(U. S. C., 1946 ed., Sec. 737.)

Sec. 352. Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, where a petition is filed under section 321 of this Act and a decree of adjudication has not been entered in the pending bankruptcy proceeding, as if a decree of adjudication had been entered in such bankruptcy proceeding at the time the petition under this chapter was filed, or, where a petition is filed under section 322 of this Act, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered at the time the petition under this chapter was filed (11 U. S. C., 1946 ed., Sec. 752).

Sec. 357. An arrangement within the meaning of this chapter may include—

(1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms;

* * * * * * *

(11 U. S. C., 1946 ed., Sec. 757.)

Sec. 366. The court shall confirm an arrangement if satisfied that

(1) the provisions of this chapter have been complied with;

(2) it is for the best interests of the creditors;

(3) it is fair and equitable and feasible;

(4) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

(5) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act. (11 U. S. C., 1946 ed., Sec. 766.)